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C O N F I D E N T I A L SECTION 01 OF 05 DAKAR 001432

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E.O. 12958: DECL: 12/16/2028
TAGS: EFIN ECON EAID PGOV KCOR FR SG
SUBJECT: SENEGAL MEETS DEADLINE BUT PROBLEMS REMAIN AHEAD
OF IMF BOARD REVIEW

REF: A. DAKAR 1431
¶B. DAKAR 1298
¶C. DAKAR 1140
¶D. DAKAR 0588

DAKAR 00001432 001.2 OF 005

Classified By: DEPUTY CHIEF OF MISSION JAY T. SMITH, FOR REASON 1.4 (B) AND (D).

¶1. (C) Summary: Senegal's Finance Minister, Abdoulaye Diop, has been scrambling to meet the prior actions and find new financing to cover the country's internal debt in advance of the IMF Board's judgment on the country's Policy Support Instrument (PSI) second review, scheduled for December 19. With some foot-dragging, the three prior actions were likely fulfilled. Diop has succeeded in raising useful money from treasury bonds, the sale of telecomm stocks, and likely from the IMF's Exogenous Shock Facility (ESF). Other sources of money are more problematic, including a large, non-concessionial loan from France. Diop is apparently under significant pressure from the Presidency to move forward dangerously on raiding public pension funds. The IMF's Resrep is not sure the Board will agree with the staff's recommendation that the second review is completed. Despite misgivings, we remain very concerned about the negative consequences that could ensue should the program fail, including the risk that Senegal would ignore the reforms already in place if there were no active IMF program. Given that the GOS is technically on track with its PSI, we recommend against a vote for non-completion, unless we are convinced, which is not currently the case, that such a move would inspire greater political will for reform from President Wade and his closest advisors. Approval of the review should be accompanied by strong and cautionary statements by both the IMF and the USG. End summary.

MEETING THE PRIOR ACTIONS

¶2. (C) On December 3, IMF Resrep Alex Segura briefed Econ Counselor on the GOS's efforts to fulfill the "prior actions" and reach agreements to close the current budget deficit in advance of the December 19 IMF Board decision on the second review of Senegal's Policy Support Instrument (PSI). Segura (protect) explained that the Ministry of Finance had likely succeeded in meeting the requirements for the three prior

actions, but Segura was dismayed by the continued political pressure being applied to the process. For the first item, on the evening of November 28, which was the deadline, President Wade signed a decree forbidding ministries or other government entities from receiving advances from the treasury before pay orders are properly processed. This action is designed to eliminate (or at least greatly reduce) the abuses that led to massive extra-budgetary spending and the large stock of unpaid bills owed to private contractors from a wide range of ministries.

¶3. (C) Segura related, however, that the initial draft decree contained broad language that would have allowed a huge range of exemptions. Another draft included language that would have allowed the decree to be ignored by a further decree from the President. Segura claimed he had to push back hard on these blatant attempts for loopholes, at one point explaining to Finance Minister Diop that the decree could be signed with the improper language, but it would no doubt be rejected at the IMF review. The final version includes four reasonable exemptions and even those need prior approval from the Finance Minister before funds can be disbursed from the Treasury.

¶4. (C) The second prior action relates to misreporting by the GOS in 2007 under the PSI's first review. To meet this requirement, the Ministry of Finance was required to publish updated budget data, including reconciliation tables, on its website, which it has done. These tables for the first time indicate the income received by Sudatel for its telecoms license -- indicating that the money came into the treasury in two payments of approximately USD 100 million each. Unfortunately, the revised data does not make clear exactly how the Sudatel money was used, but Segura believes about

half of it was used to pay debts to the private sector, based on corresponding decreases in arrears. He is less confident that the remaining funds were put to good use.

¶5. (C) One roadblock for this action item was the requirement that the GOS admit that it was guilty of misreporting its internal debt to the IMF mission in charge of the first PSI review. According to Segura, Minister Diop was loath to put any admission of misreporting into a letter or official note. Segura related that without this acknowledgement, the staff review would indicate a lack of competence on the part of the Ministry. In the end, a letter was apparently sent with highly nuanced language that Segura hopes will satisfy the Board.

¶6. (SBU) The third item is yet to be confirmed: by December 15, Senegal's legislative bodies were required to vote on Senegal's 2009 budget, which must remain in line with the framework established with the IMF's approval. The National Assembly passed the budget on November 18, and the Senate approved it on December 10. Segura's initial review of the budget law indicates that it does follow the budget framework; however, IMF staff in Washington will conduct a more thorough review to assure the spending guidelines for the ministries are appropriate.

¶7. (SBU) Segura admitted that it is unusual for the IMF to require legislative action in what is an executive branch program, but the IMF review mission believed this was an appropriate measure given the government's history of not following established budgets and the lack of accountability and transparency that has been the hallmark of the country's public finances for many years. This measure was also deemed appropriate since President Wade's PDS party maintains absolute control of both the National Assembly and the Senate and is widely believed to act in direct accordance with Wade's wishes.

FINDING MONEY: GOOD, BAD, AND DANGEROUS

¶8. (SBU) For many months, and particularly since the end of the IMF Mission in November, Minister Diop has been working non-stop to secure new financing in order to close the CFA 220 billion budget gap in a manner to satisfy the IMF Board, and also cover the CFA 174 billion-plus in arrears out of that sum that is owed to the private sector -- which President Wade promised would be paid by the end of January ¶2009. Diop's efforts have generated mixed reviews. On the positive side, the recent treasury bond issuance organized by the BCEAO on behalf of Senegal (Ref A) was oversubscribed by CFA 3 billion, with a total sale of CFA 23 billion. Segura also confirmed that Senegal would likely benefit from approximately CFA 38 billion (USD 76 million) in support under the IMF's Exogenous Shock Facility (ESF), however only half that amount would likely be available for Senegal's current needs, while the other half would have to wait until after the 3rd program review in April, 2009. How and when these funds will actually be disbursed is apparently still unclear; Segura did not believe that any ESF money had yet been delivered to countries that qualify.

¶9. (C) Under the "helpful with caveats" category, France, through the French Development Agency (AFD), agreed to loan the GOS Euro 125 million (CFA 82 billion), which was less than the CFA 120 billion Diop was reportedly asking for, but more than initial reports. (During the December 3 meeting with EconCouns, Segura received a call from Diop who was in Paris negotiating the loan and reported that AFD was only offering CFA 72 billion.) In reporting the loan, the French Press Agency noted that it was almost equal to France's entire foreign assistance package to Senegal in 2007 (Euro 127 million). Most observers believe that a major point in the negotiations for the loan was to assure that French firms who are holding unpaid contracts will be paid on a priority basis. The disbursement of the loan is dependent on both the IMF Board's approval of the PSI review (and specific approval of the loan), and the IMF's agreement to disburse the ESF credit. The loan agreement apparently stipulates that all

the money must be used to help pay off the government's internal debt (which would include the money owed to French firms).

¶10. (C) Segura shared additional details about the loan, which are somewhat troubling, namely that the interest rate is set at 6.2 percent, for five years, but with a two-year grace period. Since this rate does not meet the PSI's requirement that the GOS accepts only concessional financing, Minister Diop will likely need to request a waiver from the IMF Board. The AFD also only agreed to disburse 70 percent of the loan in 2008, withholding the other 30 percent until after the 3rd review. This will make it problematic for the GOS to both meet its goals for the current budget deficit and to erase the current stock of arrears by the end of January.

¶11. (C) For another source of funds, the GOS has apparently sold approximately two percent of its holdings in Sonatel/Orange for CFA 20 billion. These shares were already floated on the regional stock market (BRVM, based in Abidjan), and so the IMF is willing to accept this action. In a les responsible move, the GOS has reportedly receive a CFA 23 billion loan from Sonatel, ponying up ts future dividend payments from its remaining hodings as collateral. (Note: the GOS now holds a estiated at USD 950 million worth of Sonatel sock (Ref D). End note.) This transaction is casing heartburn at the IMF because if the GOS does ot stay current on its repayment of this loan, Soatel will withhold dividend payments, which woul unbalance the budget framework that includes the dividends as projected revenue.

¶12. (C) More troubling is the GOS,s current efforts to withdraw government pension and social security funds from commercial banks. The IMF, the President of Senegal's Professional Bankers' Association, and the head of Citibank's local office have all characterized this move as "dangerous"

in conversations with EconCouns. With local banks already operating on tight margins due to the extremely limited local (and international) liquidity, requests for these funds from the government require the banks to call in outstanding loans from other clients, potentially putting at risk both the banks' reserves and their clients' balance sheets. Segura confided that if the government goes though with its plan to secure up to CFA 50 billion in this manner, it could cause a run on banks. There is also widespread concern that the government will not be able to repay these funds, putting at risk pension and other social benefit payments to Senegalese citizens.

¶13. (C) The IMF has confirmed tQraiding pension funds is not necessary, in fact, it is not included within the PSI program or the negotiated "action plan" for fiscal recovery. EconCouns heard Segura tell Minister Diop by phone that he did not support this action, and offered to help negotiate a more flexible agreement on the repayment of arrears if other financing could not be secured. Diop reportedly told Segura that the goal was now to retrieve only CFA 25 billion from the social funds, which Segura still views as unacceptable. Segura related that a message is being sent from IMF management to Diop requesting that he not tap in to these social funds. However, Minister Diop is apparently in a bind because this operation was "negotiated" directly by President Wade and the president of Senegal's public employee pension fund, IPRES. Diop does not feel he has the authority to stop this initiative. Because raising funds in this manner is not a part of the action plan, there is much concern over what how this money will be used, particularly as it is being raised in advance of the stricter public finance framework that should be in place January 1. Citing the political pressure that Diop is under, Segura explained that the IMF might be willing to accept a "symbolic" transaction under this scheme, perhaps CFA 5-10 billion (USD 10-20 million) or less than 0.15 percent of GDP, while admitting that even that amount sets a dangerous precedent. (Note: Press reports have stated that President Wade's goal is to collect CFA 70 billion from the social funds, which happens to be the same amount quoted in reports for a new presidential jet, reportedly a luxury Airbus that recently was the "flying

palace" of the King of Bahrain. End note.)

WADE DOESN'T WANT TO SIGN

¶14. (C) Segura and other interlocutors remain positive about Minister Diop's efforts and commitment to fiscal reform, but acknowledge that he could become the "fall guy" if the PSI review is not completed. There are persistent rumors that Diop would like to step down, and perhaps retire from government service, but Wade is putting tremendous pressure on him to stay. Segura relates that Diop told him, with conviction, that implementing the action plan and assuring that Senegal does not become the first country to fail a PSI program is Diop's overriding goal.

¶15. (C) Unfortunately, Diop is not getting much support from President Wade. Not only are Wade's closest advisors viewed as largely responsible for the country's fiscal crisis to begin with, due to poor policies and irresponsible draws on the treasury, but Wade is apparently trying to distance himself from the responsibility for the solution. Segura related in confidence that Wade had on more than one occasion called IMF Managing Director Strauss-Kahn to demand support for Senegal and its reform efforts. In reply, Strauss-Kahn requested a letter from Wade, confirming his commitment to the PSI and fiscal reform. Wade reportedly replied that he would not do that, as it was not the proper role of a president to write to the IMF, and besides, if things did not go well, he (Wade) "should not be blamed." However, we heard, but have not confirmed, that French Economy Minister Lagarde did require and receive some sort of letter from President Wade confirming his commitment to sound fiscal

performance as a condition of the AFD loan.

THE IMF STAFF REPORT

¶16. (C) When asked about the likely outcome of the IMF Board's decision on the 2nd review, Segura admitted that he was not sure. He stated that, personally, he thought Senegal deserved approval (a completed review), but with, undoubtedly, a strongly worded statement. He claimed that there was much debate in the drafting of the Staff Report on whether or not to recommend approval, and that the report was, in it's own way, quite critical of the GOS's performance and honest about the continuing difficulties. In particular, Segura shared the conditional language in the recommendation: "staff recommends, on balance, completion of the second PSI Review. While the seriousness of the budgetary slippages made it difficult to arrive at this recommendation, the authorities' corrective actions and program commitments are sufficiently strong to warrant it."

¶17. (C) If the second review is not completed, in theory, Senegal would have a final chance to keep the program alive with the third review, but Segura thought a negative decision in December would likely be fatal. He did not agree that a rejection of the staff recommendation would further motivate the GOS to implement reforms, and would instead put at risk both further engagement (including by the broader donor community) on accountability and the credibility of the IMF in Senegal. Sogue Diarisso, one of Minister Diop's close, senior confidantes at the Ministry of Finance, also doubts that a non-approval would create new, positive motivation for Wade.

COMMENT

¶18. (C) Senegal's PSI is an ugly animal that is increasingly hard to love. Still, it's the only beast we've got to fully engage the GOS on indispensable fiscal reforms and the only independent review of the government's budget performance. The fact that President Wade is again trying to circumvent the spirit, if not the letter, of his commitment to lifting Senegal out of an economic tar-pit, largely of his administration,s doing, by raiding pension funds and potentially collapsing the banking system is distressing, to say the least. At the same time, however, that operation points to the necessity of having a current IMF engagement

that can provide some support to the Finance Minister and maintain independent access to the government's accounts. Diop is clearly under tremendous political pressure (including credible reports of threats to his life for exposing a scheme to circumvent Senegal's public procurement code when the government made a non-competitive agreement for a new power plant), but we still believe he is trying to do the right thing, and would no doubt unfairly be blamed for any program failure.

¶19. (C) Technically, the GOS met its prior actions, and within the narrow confines of the program remains on track. In this way, the PSI is working as advertised by putting significant pressure on the government to undertake specific reforms within a strict timeframe. Under a PRGF it is likely that the government would have stalled on most of the measures that have been taken, and the review/reporting dates might well have been postponed. It falls to the IMF (and donors) to assure that the required prior actions and the agreement memos are ambitious and address the real problems. Missing from the program is a mechanism for assuring political will from President Wade and his circle for the spirit of the program -- greatly improving public finance management and accountability. The big question is, would a non-completion of the second review help or hurt the effort to motivate political will?

¶20. (C) We recommend that the USG vote to concur with the

staff recommendation to conclude the second review. After that we'll have a better idea if the important new reforms that were imposed on Wade's administration will be allowed to be implemented. We would also like to see the Board issue some pointed language admonishing the GOS for foot-dragging, and noting that without a public commitment from President Wade and his entire government, the country will not be able to solve its economic slide. Washington should echo those sentiments.
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